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E FOR THOMAS PIERCE  
PASS NSC FOR JOSE CARDENAS  
PASS FED BOARD OF GOVERNORS FOR PATRICE ROBITAILLE  
PASS USTR FOR EEISSENSTAT, SCRONIN, MSULLIVAN  
TREASURY FOR AFAIBISHENKO, NLEE  
USDOC FOR 4322/ITA/MAC/OLAC/PEACHER  
US SOUTHCOTM FOR POLAD

E.O. 12958: N/A

TAGS: [ECON](#) [FINV](#) [OPIC](#) [USTR](#) [AR](#)  
SUBJECT: ARGENTINA INVESTMENT CLIMATE STATEMENT 2007

¶1. This cable transmits the text of the Argentina  
Investment Climate Statement for 2007

#### OPENNESS TO FOREIGN INVESTMENT

Argentina remains open to foreign investment. Four consecutive years of real GDP growth over 8 percent have attracted considerable U.S. and other international investor interest in exploring opportunities in the Argentine market. The government of Argentina, in turn, has signaled its desire to see foreign direct investment (FDI) expand significantly to enhance the nation's productive capacity and sustain high levels of real GDP growth. However, legal uncertainties concerning creditor and contract rights and frequent and unpredictable regulatory changes diminish the attractiveness of some sectors for foreign investors.

In 1991, the government of Argentina (GoA) pegged the Argentine peso to the U.S. dollar at a 1:1 exchange rate (?convertibility?) with the aim of breaking the back of hyperinflation and adopted far-reaching market-based policies, including dismantling a web of protectionist trade and business regulations, and reversing a half century of statism by implementing an ambitious privatization program. Argentina subsequently received significant increases in investment, with FDI inflows among the highest in Latin America through most of the 1990s. While convertibility defeated inflation, over time its permanence, combined with lack of fiscal discipline and poor governance, undermined Argentina's export competitiveness and created chronic deficits in the current account of the balance of payments, which were financed by massive borrowing. The contagion effect of the Asian financial crisis of 1998 precipitated an outflow of capital that contributed to a 4-year recession that culminated in a

financial panic in November 2001. In December 2001, the government ended convertibility and defaulted on \$82 billion in debt, the largest sovereign debt default in history. A number of bondholders are actively seeking redress.

In February 2005, investors holding 76 percent of Argentina's defaulted principal accepted a government offer of approximately 30 cents per dollar face value of old debt in what became the largest sovereign restructuring in history. Argentina owes approximately \$7.2 billion to official government creditors (including \$359 million to the U.S. government), of which over \$3.5 billion consists of arrears and past due interest. The GoA has indicated interest in normalizing its relationship with official government creditors. As of this writing, however, the GoA has declined to deal with private bondholders who chose not to participate in the 2005 restructuring.

The surge in Argentina's real GDP growth over the past four years was largely due to a boost in domestic aggregate demand stimulated by the government's fiscal, monetary and income distribution policies. Argentina posted real GDP growth of 8.8 percent in 2003, 9.0 percent in 2004, 9.2 percent in 2005, and an estimated 8.4 percent in 2006. This impressive economic recovery, which has led to improvements in key socio-economic indicators, can be attributed to a number of factors. First, following reforms in the 1990s, Argentina's economy was fundamentally sound except for the high level of indebtedness. Second, the move away from convertibility combined with favorable international commodity price, interest rate and global growth trends were catalytic factors in supporting

Argentina's growth. Third, the government has worked hard to maintain a primary fiscal surplus and continues to accumulate reserves. Argentina should continue to perform well in 2007 with GDP growth projected in the 7 percent range. Nevertheless, slowness in addressing the post-crisis re-negotiation of public service contracts, capacity constraints, potential energy shortages in the face of high growth and distorted energy prices, inflation and the government's policies to contain it (including pressure on the private sector to maintain price controls) pose potential obstacles to sustaining Argentina's economic recovery.

Industrial activity has performed well, growing from 16 percent of GDP in 2001 to 23 percent in 2005. Illustrative of this industrial expansion, in 2006 the domestic car industry had its best year since 1998, with production up 35 percent from 2005 to an estimated 432,100 units and automotive exports, which comprise about 55 percent of total production, up 30 percent from 2005 to an estimated 236,800 units. Meanwhile, tourism continued its strong growth, with Argentina receiving an estimated 4.1 million foreign tourists in 2006, also a record.

Argentina's economic expansion continues to create jobs, and unemployment continues to decline, down from 21.5 percent during the 2002 economic crisis to 10.2 percent during the third quarter of 2006. Investment in real terms is forecast by the Central Bank to have jumped 18.3 percent in 2006. The recovery's strong impact on government revenue collections combined with a boost in the consolidated tax burden from 21 percent of GDP in 2000 to 31 percent in 2006 allowed the consolidated primary fiscal surplus to reach 3.6 percent of GDP in 2006, and the surplus after interest payments was 2.0 percent of GDP. However, recent substantial increases in federal and provincial public spending may reduce or eliminate the consolidated fiscal surplus in coming years.

Meanwhile, the move from convertibility to a managed float exchange rate regime and high global commodity prices have lifted exports to record levels and hefty surpluses in Argentina's trade and current account balance of payments.

These balance of payments surpluses have allowed an accumulation of foreign exchange reserves which reached USD 32 billion at the end of 2006, almost 12 months of current imports. In early 2006, the GoA used reserves to pay down its \$9.5 billion of debt with the IMF.

Argentina's Central Bank has managed monetary and currency policy in support of the economic expansion and maintaining low real interest rates. Such policies have also contributed to substantial inflationary pressures. To help control inflation, the government has frozen key public utility tariff rates since 2002 and, since 2005, has negotiated price stabilization agreements on a sizeable basket of essential consumer goods. As a result, reported consumer inflation dropped from 12.3 percent in 2005 to an estimated 9.8 percent in 2006. However, real core inflation remains several points higher than indexed inflation.

Private sector bank balance sheets, which deteriorated significantly during the economic crisis, are recovering, with improving levels of liquidity, net exposure to the public sector significantly reduced, and credit ? primarily to the private sector -- increasing at a faster pace than nominal GDP growth. Most private banks have returned to solvency, both in terms of profitability and quality of

portfolio. The ratio of non-performing loans has fallen to a historic low of approximately 5 percent, and profits for the overall banking system are at the highest levels in over a decade. However, new lending is mostly short-term, as access to long-term financing is limited and borrowers are reluctant to borrow long-term at variable rates. Uncertainty about the levels of long-term inflation will continue to complicate GoA and private sector efforts to develop a long-term fixed interest rate market, without which it will be difficult to deepen Argentina's mortgage market or engage in large-scale project finance.

Decree 1853/1993 governs foreign investment in Argentina. According to this decree, foreign companies may invest in Argentina without registration or prior government approval, and on the same terms as investors domiciled in Argentina. Investors are free to enter Argentina through merger, acquisition, Greenfield investment, or joint venture. Foreign firms may also participate in publicly financed research and development programs on a national treatment basis. In June 2003, Argentina enacted legislation limiting foreign ownership of "cultural goods," which includes media and Internet companies, to 30 percent. An exception to the 30 percent limit is made for investors from those countries whose foreign investment regimes allow more than 30 percent foreign ownership of cultural goods. This law also exempts media companies from "cramdown" rules in restructuring and bankruptcy.

A Bilateral Investment Treaty (BIT) between Argentina and the United States entered into force in October 1994. The BIT provides protections against capital movement restrictions, expropriations, and performance requirements; it also establishes effective means for the settlement of investment disputes. The BIT lists a few sectors in which Argentina maintains exceptions to national treatment for U.S. investors: real estate in border areas, air transportation, shipbuilding, nuclear energy, uranium mining, and fishing. U.S. investors must obtain permission from the Ministry of Defense's Superintendency for Frontiers to invest in non-mining activities in border areas.

Foreign and Argentine firms face the same tax liabilities. In general, taxes are assessed on consumption, imports and exports, assets, financial transactions, and property and payroll (social security and related benefits). In June 2003, Argentina announced that it would review more closely the tax declarations of foreign corporations operating in Argentina. The professed aim of this measure is to crack

down on the use of offshore shell corporations to shelter profits and assets from taxation.

The GoA has established a number of investment promotion programs. Those programs allow for VAT refunds and accelerated depreciation of capital goods for investors (although numerous investors have reported difficulties and delays in obtaining expected VAT refunds); offer tariff incentives for local production of capital goods; and include sectoral programs, free trade zones, and a special Foreign Trade Area in Tierra del Fuego, among other benefits. A complete description of the scope and scale of Argentina's investment promotion programs can be found at <http://www.industria.gov.ar/>. Information about programs that specifically apply to small and medium businesses may be found at <http://www.sepyme.gov.ar/>.

According to the World Bank's latest ?Doing Business? survey, Argentina in 2006 ranked 101 out of 175 nations

surveyed in overall ?ease of doing business,? down from 93 in 2005. The survey considered issues such as: starting a business; dealing with licenses; employing workers; registering property; getting credit; protecting investors; paying taxes; trading across borders; enforcing contracts; and closing a business.

#### CONVERSION AND TRANSFER POLICIES

Until the end of 2001, Argentine law offered a number of protections for free capital and currency transfers. Law 21382, Article 5 (as implemented by Decree 1853/1993), allows foreign investors to repatriate capital and remit earnings abroad at any time. Article V of the United States-Argentina BIT also provides for free, prompt transfers related to investments. In the wake of the 2001-2002 crisis, however, the GoA instituted and subsequently modified an array of emergency transfer and currency conversion restrictions. The number of new regulations and the frequency of policy changes have generated considerable uncertainty for investors. Fourteen U.S. investors have submitted claims against the GoA to binding investor-state arbitration under the BIT, making the case that measures imposed by Argentina during the financial crisis that began in 2001 breached BIT obligations.

The GoA Ministry of Economy and the Central Bank have issued various new or revised foreign exchange transaction regulations in an attempt to normalize the foreign exchange market and to limit the peso's appreciation. In nominal terms, the Argentine peso depreciated 70% in 2002, following the financial crisis that began in December 2001. The peso subsequently appreciated 15% percent against the USD in 2003, and slightly depreciated by 1% in 2004, 2% in 2005, and 1% in 2006.

Argentina imposed limited capital controls in July 2003 through Decree 285/2003, which establishes a regimen for capital inflows and outflows. The decree obliges investors to keep foreign currency inflows in the country for a period of at least 180 days. In June 2005, the government further tightened capital controls through Decree 616/2005. The decree increased the minimum holding period for capital inflows from 180 to 365 days and established that some capital inflows are subject to a 30 percent unremunerated reserve requirement to be deposited in a local bank for 365 days. This deposit must be denominated in USD and the proceeds cannot be used as collateral. The remaining 70 percent is free to be invested, but is subject to the 365-day minimum holding period. Capital inflows related to trade transactions, foreign direct investment or to primary public offerings of stock or bonds (from both the private and public sector) as well as inflows from International Financial Institutions are exempt from controls. Decree 616 differentiated from previous regulation as it attempted to discourage capital inflows by increasing the cost of bringing capital into the country.

A resident individual or company is allowed to purchase up to USD 2 million per month of foreign currency without Central Bank authorization. Any excess is subject to the restrictions (e.g. 30 percent reserve requirement and 365-day minimum investment period). In December 2006, the Central Bank established that capital inflows and outflows must be registered under a person's or business' name, whereas in the past transactions could be registered generically under the local brokerage/exchange house. There are special rules regulating the purchase of foreign currency to settle financial debt, and for the private

issuance of bonds denominated in foreign currency.

Decree 260/2002 lifted official conversion rates that had been established in early 2002. With this decree, the market determines the rate of exchange, with Central Bank intervention, and subject to rules established by the Central Bank. The Central Bank intervenes frequently in the foreign exchange market, with the objective of maintaining a competitive peso.

#### EXPROPRIATION AND COMPENSATION

Article 4 of the United States-Argentina BIT states that investments shall not be expropriated or nationalized except for public purpose upon payment of prompt fair-market value compensation. However, some U.S. investors claim the January 2002 pesification of dollar-denominated contracts amounts to an effective expropriation of their investments. A number of these investors have filed international arbitration claims against the government of Argentina.

#### DISPUTE SETTLEMENT

The GoA accepts the principle of international arbitration. The United States-Argentina BIT provides for binding international arbitration of investment disputes that cannot be settled through amicable consultation and negotiation between the parties. The government of Argentina is a party to the International Center for the Settlement of Investment Disputes (ICSID), The United Nations Commission on International Trade Law (UNCITRAL), and the World Bank's Multilateral Investment Guarantee Agency (MIGA). Companies that seek recourse through Argentine courts, however, may not also pursue recourse through international arbitration.

In April 2003, the GoA issued Decree 926/2003, which created two new agencies to carry out amicable negotiations under bilateral investment treaties, including the United States-Argentina BIT. The "Amicable Negotiations Federal Council" (ANFC) made up of representatives of the Ministry of Foreign Affairs, the Ministry of Economy and the Federal Attorney General's Office, had a mission to devise the government's strategies and policies in negotiations with foreign investors and could approve proposals made during negotiations. However, in July 2003 that body was replaced by the "Unit for the Renegotiation and Analysis of Utility Contracts" (UNIREN), which was created to serve essentially the same function, but which is presided over jointly by the Ministers of Planning and Economy. The other entity created by Decree 926/2003 is the "Amicable Negotiations Proceedings Body," which works under the Federal Attorney General. It receives investor complaints, gathers information and carries out negotiations with foreign investors.

Domestic investment dispute adjudication is available through local courts or administrative procedures. However, independent surveys indicate that public confidence in the Argentine judiciary remains weak. Therefore, many foreign investors rely on private or international arbitration when those options are available. Argentina has a strict bankruptcy law similar to that of the United States.

However, initiating bankruptcy proceedings is more difficult in Argentina. Creditors can participate in a Chapter 11-like procedure to determine the best means of recovering debts from a bankrupt firm. Company directors are personally and criminally responsible in cases of

fraud, although severe punishment for white-collar crime is rare. There have been allegations of corruption in the administration of bankruptcies and the selection of bankruptcy trustees.

As noted above, a number of U.S. investors have filed ICSID arbitration claims against the government of Argentina. Most of these investors consider the January 2002 pesification of dollar-denominated contracts, and/or the ex post facto prohibition on contracts linked to foreign inflation indices, to be an effective expropriation of their investments. Prior to pesification, some U.S. investors engaged in disputes with provincial governments over unforeseen changes in tax laws and liabilities (often in spite of tax-stability guarantees from provincial and federal authorities). Customs treatment and the freeze on public utility rate changes have also provoked investment disagreements. There were 33 pending cases involving Argentina before the ICSID tribunal as of mid-December 2006, 32 percent of total pending ICSID cases with claims amounting to USD 13.3 billion, 6.5 percent of projected 2006 GDP. Over the past two years several ICSID claimants have suspended active claims to facilitate further negotiation with the government.

In a December 2006 decision on the 2002 pesification decree, the Supreme Court ordered banks to reimburse depositors in local currency the total value of deposits originally held in U.S. dollars that had earlier been frozen. The decision also upheld the legality of this pesification decree, which froze bank deposits and forcibly converted dollar savings into devalued pesos. The ruling ordered banks to compensate depositors at 3.08 pesos to the dollar -- equal to the pesified deposits they would now hold under the original decree, and applying a currency conversion rate of 1.40 pesos per dollar, adjusts for inflation and adds a 4 percent annual interest rate to be applied retroactively since the pesification began.

#### PERFORMANCE REQUIREMENTS AND INCENTIVES

No performance requirements are aimed specifically at foreign investors. Government incentives apply to both foreign and domestic firms. The Ministry of Economy administers a complex trade-balancing regime involving quotas and tariffs for auto manufacturers including minimum-content and other requirements. Special regimes also apply to mining, oil and gas, and other natural resource sectors. The special regimes allow producers to keep all (as in the case of mining) or 70 percent of their foreign exchange revenues off-shore (as in the case of oil and gas, fisheries and forestry).

#### RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

Foreign and domestic investors have free and equal rights to establish and own businesses, or to acquire and dispose of interests in businesses without discrimination. However, as noted above, in June 2003 Argentina enacted legislation limiting foreign ownership of "cultural goods," which includes media and Internet service providers companies, to 30 percent. The Embassy is monitoring a case in which U.S. media investors allege that the government of Argentina, citing the "cultural goods" law, has refused to recognize their ownership stake. An exception to the 30 percent limit is made for investors from those countries whose foreign investment regimes allow more than 30 percent foreign ownership of cultural goods. This law also exempts media companies from "cramdown" rules in restructuring and

bankruptcy.

#### PROTECTION OF PROPERTY RIGHTS

Secured interests in property, including mortgages, are recognized and common in Argentina. Such interests can be easily and effectively registered. They also can be readily bought and sold. However, in February 2002, the government of Argentina established an extended moratorium prohibiting financial institutions from foreclosing on delinquent mortgages on primary residences. In November 2006, the government of Argentina established a law that allowed owners of primary homes of limited value to pay down their dollar-based mortgages, at a below-market exchange rate of 1.8 pesos to the dollar.

The government of Argentina adheres to most treaties and international agreements on intellectual property and belongs to the World Intellectual Property Organization and the World Trade Organization (WTO). The Argentine Congress ratified the Uruguay Round agreements, including the provisions on intellectual property, in Law 24425 on January 5, 1995. However, enforcement of intellectual property rights is problematic in Argentina.

**Patents:** Patent law is an ongoing problem in Argentina's intellectual property rights regime, and extension of adequate patent protection to pharmaceuticals has been a highly contentious bilateral issue. In early 1997, the U.S. announced the suspension of 50 percent of Argentina's trade benefits under the Generalized System of Preferences (GSP) because of inadequate protection of pharmaceutical products. In November 2000, after years of protracted debate, a new patent law took effect. This law improved earlier Argentine patent legislation, but provides less protection than that called for in the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). However, the government's dedication of additional resources to patent adjudication over the past three years has substantially increased the number of patents issued, including in the pharmaceutical area. In April 2002, the United States and Argentina reached an agreement with respect to most of the claims in a World Trade Organization (WTO) dispute brought by the United States with respect to Argentina's implementation of its TRIPS obligations. Two issues, including the critical issue of data protection, remain unresolved. The United States and Argentina have agreed to leave these issues within the WTO dispute settlement mechanism for action. Legislation implementing the April 2002 agreement was passed in December 2003. However, certain U.S. and European pharmaceutical firms are concerned that provisions in the legislation undercut their ability to protect patented products through judicial injunctions

**Copyrights, Trademarks, Trade Secrets, and Semiconductor Chip Layout Design:** Despite the fact that Argentina's copyright law dates to 1930, it provides a generally good legal framework to protect intellectual property such as books, films, music, and software. However, the economic crisis of 2002 led to an increase in the use of unlicensed software and optical media. Piracy rates of CDs, DVDs and software are all estimated at over 50 percent. Enforcement continues to be sporadic and pirated products are widely available in the market. That said, Argentine authorities began in late 2004 to show signs of a more proactive posture regarding product piracy. Specifically, the government of Argentina passed laws designed to allow

authorities to mount undercover operations for the first time; to electronically flag suspect shipments; to facilitate the seizure and detention of suspect merchandise; and to more frequently rotate customs personnel, among other provisions. A January, 2005 law which allowed Customs officials to seize shipments which violate IP rights ? and detain them based on the

presumption of IP violations, pending a formal decision ? was implemented in October, 2006. The government has also improved the process for trademark registration, decreasing the time needed and increasing the rate at which trademarks are registered. Argentina has no specific law on trade secrets, although penalties for unauthorized revelation of

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secrets are applied to a limited degree under commercial

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law. Argentina has signed the WIPO Treaty on Integrated Circuits, but has no law dealing specifically with the protection of layout designs and semiconductors.

#### TRANSPARENCY OF THE REGULATORY REGIME

During the 1990s, the GoA eliminated virtually all restrictions on domestic and foreign trade of goods and services, as well as on financial markets. These policies increased competition in many industries and sectors. Argentine authorities, including the Ministry of Economy and a number of quasi-independent regulatory entities, have also acted in certain cases to foster competition and protect consumers, though not always in a transparent fashion.

Frequent changes to the bankruptcy law during early 2002 increased creditor insecurity. In January 2002, the Argentine National Congress passed several amendments to the bankruptcy law that increased debtors' powers considerably, but the National Congress restored many of the law's earlier protections for creditors in May of that year.

Other regulatory changes in 2002 added to creditor insecurity. The GoA announced in May 2002 that an emergency decree passed in late 2001 had voided the presidential decree that authorized oil and gas companies to keep 70 percent of their foreign exchange revenues offshore. This decree formed the financial basis for most foreign investment in the Argentine oil sector. The GoA's discovery that the decree had been voided inadvertently months before came at a time when the government of Argentina was worried about its access to foreign exchange and the devaluation of the peso. When the peso began to appreciate, the government of Argentina issued a new decree that gave the industry the same right to withhold 70 percent of revenues starting January 1, 2003, but the industry remains liable for failing to repatriate 100 percent of its revenues during the 13-month period from December 2001 and December 2002. The Central Bank opened proceedings against some oil and gas producers in 2004 for alleged criminal breach of the exchange regime.

The GoA's actions since 2003 have not calmed investor concerns about the regulatory environment. The GoA issued a decree de-pesifying foreign currency-denominated contracts of foreign firms doing business in Argentina in 2003, but then withdrew the decree and said it was a mistake. In the energy sector, the GoA took measures to avoid energy shortages that arose from the increase in demand for natural gas and electricity in 2004, including ordering reductions in natural gas exports to Chile and electricity exports to Uruguay; importing natural gas from Bolivia and electricity from Brazil; raising tariffs for industrial

users; providing incentives to small users to save energy; and intervening in the wholesale markets for natural gas and electricity. The GoA has also encouraged companies to invest in the expansion of natural gas pipelines, and has encouraged power companies to invest compensation owed them by the GoA in new power generation plants. There is concern that the above mentioned GoA actions in the energy sector, coupled with the GOA's efforts to control retail prices of fuels, have created disincentives for companies to invest in energy exploration and infrastructure.

Inadequate investment in those areas could, in turn, result in energy supplies not keeping pace with demand generated by Argentina's rapid economic growth.

In general, national taxation rules do not discriminate against foreigners or foreign firms (e.g., asset taxes are applied to equity possessed by both domestic and foreign entities). Nevertheless, a number of these taxes may impact their investment decisions. As noted above, in June 2003, the government of Argentina announced that it would review more closely the tax declarations of foreign corporations operating in Argentina. The professed aim of this measure is to crack down on the use of offshore shell corporations to shelter profits and assets from taxation.

At the national level, there are three major taxes: an income tax, export taxes imposed in 2002, a financial transactions tax and a value added tax (VAT). The income tax law presumes that every company earns a profit, and based on this presumption, all firms are required to pay one percent of the value of their assets involved in the production process to the state. If a company is later able to establish that it did not earn a profit, the company will be reimbursed in five years. Export taxes are tariffs imposed on the export of all goods, with rates from 5 percent to 45 percent. The financial transactions tax imposes a 0.6 percent on all checking account payments within the national banking system. The VAT is set at 21 percent for most products. The VAT is 10.5 percent for interest and commissions on debts taken by public transportation companies, fruits, vegetables, honey, newspapers and magazines, and some capital goods. The VAT is 27 percent for natural gas, electricity, water and sewage services. Exporters should receive VAT rebates, but many companies have experienced extensive delays in their receipt of VAT rebates.

At the provincial level, the system of provincial sales taxes has encouraged vertical integration of firms. Investors also have expressed increasing concern over the incidence of municipal "supply taxes". The Argentine constitution gives municipalities the right to set fees for the services that they provide, including supply taxes. Many investors allege that the supply tax fees charged by municipalities do not correspond to the services provided. Municipalities have levied fees on the food industry, in particular, through a range of sanitary controls that occasionally overlap national and provincial regulations. Supply tax fees have affected other industries as well. Municipalities in Buenos Aires and Cordoba provinces have generated the most serious complaints. Many municipalities have begun imposing fees on any advertising visible from the public street, including in-store promotion materials, such as soft drink coolers, ashtrays and the packaging of individual consumer items, such as batteries.

#### EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

Law 17811 of 1968 regulates public securities offerings.

The Argentine Securities and Exchange Commission (Comision Nacional de Valores) is the federal agency that regulates securities markets offerings. Securities and accounting standards are transparent and consistent with international norms.

U.S. banks, securities firms and investment funds are well represented in Argentina and are dynamic players in the local capital markets. The private pension fund system -- consolidated in 1995 -- provided an important growing base for capital markets until the 2001-2002 economic and financial crisis. Following the government's 2005 debt restructuring private pension funds have again become significant players in domestic capital markets. In July 2003, the government began requiring foreign banks to disclose to the public the nature and extent to which their foreign parent banks guarantee their branches or

subsidiaries in Argentina.

#### POLITICAL VIOLENCE

Protests, marches, and roadblocks directed at the national, provincial and municipal governments are commonplace in Argentina, but their number, size, and the likelihood of accompanying violence have decreased since the crisis.

There have been no cases of overtly political violence since the April 2003 national presidential election.

During 2004, however, in what appear to have been mostly unrelated incidents, unknown persons placed thirteen bombs, which either exploded or were detonated by police, and four other incendiary devices in banks and other commercial establishments. One bank guard was killed and a policeman seriously injured in December 2004. In 2005, there were approximately 20 incidents in which local groups were involved in bombings, attempted bombings, or arson, mostly against U.S. businesses (Citibank, Bank Boston, Blockbuster, and McDonald's in particular). Anti-American pamphlets or graffiti were found at most of the 2005 incidents, none of which resulted in injury or death.

In protest against the construction of a \$1.2 billion pulp mill on the Uruguayan side of a river that defines the Argentine/Uruguay border, Argentine citizens have blocked a bridge that connects the two nations for much of 2006. The pulp mill project is being financed and insured by World Bank agencies and has met all relevant World Bank environmental safeguards. The Mercosur trade block's arbitral tribunal considered the case in 2006 and found the block illegal and a violation of the right of free transit of goods and services in the region. Nonetheless, the Government of Argentina has refused to intervene, a decision that has led to a deterioration of relations between the two countries. Argentina asked the International Court of Justice to issue an injunction halting the plant's construction, as well as its opinion on whether construction of the plant violated a 1975 Argentine-Uruguayan treaty dealing with its shared river. In mid-2006, the International Court refused to impose such an injunction and is expected to render a final decision on the case in 2007.

#### CORRUPTION

Government corruption and private sector business fraud are the subjects of frequent complaints from U.S. investors. U.S. businesses have identified corruption in Argentina as a significant problem for trade and investment, particularly in procurement, regulatory systems, tax collection, and health care administration. In the latest

annual Transparency International survey of Corruption Perceptions Index that ranks countries by their perceived levels of corruption, Argentina ranked 93rd out of 163 countries, below the average among Latin American countries, and far behind neighbors Chile and Uruguay. Such surveys have contributed to more open debate in Argentina about corruption and fraud. Some foreign firms complain that their adherence to the letter of the tax and regulatory codes places them at a competitive disadvantage vis their domestic competitors. There are indications that the GoA is trying to change the culture of tax evasion by stepping-up enforcement efforts and encouraging the use of credit card purchases while at the same time using the media to increase public awareness of tax obligations and to shame evaders. While Argentina's growing economy is primarily responsible for the government of Argentina's solid fiscal performance, anti-evasion efforts were a factor in the federal government's record tax collections of about 150 billion pesos in 2006, up from around 118 billion in 2005 and 98 billion in 2004.

Argentina is a party to the OAS Anti-Corruption Convention and ratified the OECD Anti-Corruption Convention in 2001. The government has regulations against bribery of

government officials, but enforcement is uncertain. An anti-corruption office under the Ministry of Justice reviews the financial disclosure statements that are now required of all senior public officials. The anti-corruption office also carries out investigations into cases of alleged corruption involving Executive branch officials.

Inefficiencies in the Argentine judicial system slow efforts to stem corruption. Argentine laws do not provide for plea-bargaining, so many corruption charges are difficult to prosecute. As a result, convictions are rare.

#### BILATERAL INVESTMENT AGREEMENTS

The governments of Argentina and the United States signed a BIT in 1991. The agreement was amended, ratified by the Congresses of both countries, and entered into force on October 20, 1994. Argentina does not have a bilateral tax treaty (Treaty for the Mutual Avoidance of Double Taxation) with the United States.

At present, the GoA has signed and ratified bilateral treaties for the protection and promotion of investment with all of its major trade and investment partners. More information regarding Argentina's bilateral tax and investment treaties is available at [www.infoleg.gov.ar](http://www.infoleg.gov.ar).

Argentina has valid double taxation treaties with the following countries: Australia, United Kingdom, Denmark, Germany, Belgium, Austria, France, Italy, Sweden, Switzerland, Spain, Canada, Chile, Bolivia, Brazil, Finland, Norway, and the Netherlands. In addition thereto, a number of treaties concerning the exemption of income from international transport are in force.

#### OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

The government of Argentina signed a comprehensive agreement with the Overseas Private Investment Corporation (OPIC) in 1989. The agreement allows OPIC to insure U.S. investments against risks resulting from expropriation, inconvertibility, war or other conflicts affecting public order. OPIC programs are currently used in Argentina. Argentina is also a member of the World Bank's Multilateral

Investment Guarantee Agency (MIGA).

#### LABOR

Argentine workers are among the more highly educated in Latin America. Argentine workers were relatively well paid by international standards prior to the peso devaluation in January 2002. While high inflation following the 2002 devaluation significantly eroded the purchasing power of wages, sustained government-promoted increases in public and private sector nominal wage levels from 2003 have reversed this trend. Wages in dollar terms remain competitive, even taking into account Argentina's relatively high social security charges and other taxes. As of the third quarter of 2006, the official unemployment rate was 10.2 percent, down from 21.5 percent in 2002, but this number excludes recipients of government assistance to unemployed heads of households. If those recipients were included, unemployment would be approximately 12.1 percent.

Organized labor continues to play a strong role in Argentina. Sector-specific negotiations between unions and industry, although largely market driven, have often been influenced by government suasion on behalf of unions. In the 2002-2004 period, a number of general wage increases were mandated by presidential decree.

With the unemployment rate projected to fall below 10 percent in 2007, numerous employers have commented on an increasing shortage of skilled labor. The GoA passed a modest labor reform law in 2000 to address rigidities in

the labor market (i.e., by increasing collective bargaining flexibility, extending trial employment periods, and lowering payroll taxes for new permanent hires). However, the anticipated growth in employment did not materialize, as the reforms coincided with a deepening of the economic recession produced by foreign and domestic factors.

Following the acceleration of the financial crisis beginning in December 2001, many workers left the formal labor force and instead began to work informally, as employers sought to avoid high pension, social security, and other taxes on formal employment. The government passed a new labor law reform in 2004, which did not result in significant changes to the existing regime. According to the World Bank's *Doing Business* survey mentioned above, the cost of terminating an employee in Argentina averaged 138 weeks of wages, almost double the Latin American average of 59 and more than four times the OECD average of 31.

#### FOREIGN TRADE ZONES/FREE PORTS

Argentina has two types of tax-exempt trading areas: Foreign Trade Zones (FTZs), which are found throughout the country; and the more comprehensive Special Customs Area (SCA), which covers all of Tierra del Fuego Province and whose benefits apply only to already established firms.

Law 24331 of 1994 establishes the FTZ regime for Argentina. Argentine law defines an FTZ as a territory outside the *?general customs area?* (GCA, i.e., the rest of Argentina) where neither the inflows nor outflows of exported final merchandise are subject to tariffs, non-tariff barriers, or other taxes on goods. Goods produced within a FTZ generally cannot be shipped to the GCA, unless they are capital goods not produced in the rest of the country. The labor, sanitary, ecological, safety, criminal, and financial regulations within FTZs are the same as those that prevail in the GCA. Foreign firms get national treatment in FTZs.

Under the current law, the Executive Power may create one FTZ per province, with certain exceptions. More than one FTZ per province may be allowed in sparsely populated border regions (although this provision has not been fully utilized). Thus far, the National Executive Power has permitted FTZs in most of the 24 Argentine provinces. The most active FTZ is in La Plata, the capital of Buenos Aires Province.

Merchandise shipped from the GCA to a FTZ may receive export incentive benefits, if applicable, only after the goods are exported from the FTZ to a third country destination. Merchandise shipped from the GCA to a FTZ and later exported to another country is not exempt from export taxes. Any value added in FTZs and re-exports from FTZ is exempt from export taxes.

Law 19640, passed in 1972, codifies the Special Customs Area (SCA) rules for Argentina. Unlike FTZ manufactured goods, products manufactured in an SCA may enter the GCA free from taxes or tariffs. In addition, the government may enact special regulations that exempt products shipped through an SCA (but not manufactured therein) from all forms of taxation except excise taxes. The SCA program provides benefits for established companies that meet production and employment objectives.

The SCA program applies only to Tierra del Fuego Province. The government reduced some SCA benefits in the early 1990s. Most of these benefits were later reestablished, but only for those firms previously established in Tierra del Fuego Province. The SCA program is scheduled to expire at the end of 2013. In late 2006, Economic Ministry Resolution 776 abolished export tax exemption enjoyed by oil companies operating in Tierra del Fuego Province.

#### FOREIGN DIRECT INVESTMENT STATISTICS

As of the end of 2005 (the latest date available), the total stock FDI in Argentina was estimated at \$55 billion, with Spain, the United States and France the top three investors. In 2005, the total FDI inflows were estimated at \$4.6 billion. The stock of U.S. FDI in Argentina in 2005 was estimated at \$13.2 billion. U.S. investment is concentrated in financial services, agribusiness, energy, petrochemicals, food processing, household products, and motor vehicle manufacturing. Many U.S. firms substantially wrote down the value of their Argentine investments in response to the devaluation and pesification of previously dollar-denominated contracts.

Other important sources of investment capital include Canada, Mexico, U.K., Italy, Chile, the Netherlands and Germany. During a visit to Argentina by PRC President Hu Jintao in November 2004, public and private Chinese companies signed letters-of-intent for sizeable investments over the coming decade in Argentina's transportation, hydrocarbons, mining, construction, telecommunications, and tourism sectors.

In 2005, Argentina received 1.4 percent of foreign direct investment (FDI) inflows to developing countries, and 5.9 percent of FDI inflows to Latin America. Both of these shares are well below Argentina's average FDI share from the pre-crisis 1992-2000 period.

Argentine firms increasingly invested abroad during the 1990s (particularly in Brazil, Paraguay and Uruguay),

although the country has remained a net recipient of foreign direct investment.

The Argentine Ministry of Economy (<http://www.mecon.gov.ar>) and the Investor's Information Service for Argentina (<http://www.infoarg.org>) have additional detailed information on foreign direct investment in Argentina.

WAYNE